OPENING STATEMENT OF
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SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON THE LONG AND SHORT OF HEDGE FUNDS:
EFFECTS OF STRATEGIES FOR MANAGING MARKET RISK

THURSDAY, MAY 22, 2003

Mr. Chairman, we meet today for the first time since our subcommittee considered legislation in 2000 in response to the collapse of Long Term Capital Management to explore the issue of hedge funds. Created more than five decades ago, hedge funds have largely operated on the periphery of our nation's capitalistic system with limited regulatory oversight, restricted investor access, and little public disclosure. Nevertheless, hedge funds, in my view, have played an important and crucial role in the ongoing success of our capital markets.

Before we hear from our witnesses, it is important to review some basic facts about the size and scope of the hedge fund industry. Today, experts estimate that there are between 6,000 and 7,000 hedge funds operating in the United States. The hedge fund industry has also grown substantially in recent years. According to several estimates, hedge funds managed $50 billion in 1990, $300 billion in 2000, and $650 billion in 2003. Moreover, although hedge fund holdings represent about four percent of the value of the stock market, the *Wall Street Journal* recently reported that hedge fund trading accounts for nearly a quarter of the daily volume.

As our capital markets have continued to evolve in dramatic ways during the last decade, hedge funds have attracted the attention of many of our nation's investors, particularly those who want to earn higher returns in today's chaotic markets. Because of their entrepreneurial investment strategies and their independence from the legal requirements applied to other securities products, hedge funds can generate positive returns even during bear markets.

Additionally, hedge funds have attracted the attention of our regulators. In February, for example, the National Association of Securities Dealers issued a notice to brokers reminding them of their obligations when selling hedge funds. Last year, the Securities and Exchange Commission also began a comprehensive review of a number of issues related to hedge funds, including their recent growth, trading strategies, regulatory oversight, and transparency. In its investigations, the Commission has also worked to examine the retailization of hedge funds.

As my colleagues know, investor protection is a top priority for my work on this panel. From my perspective, a hedge fund is a very sophisticated securities instrument. As a result, only very sophisticated individuals with adequate resources and sufficient diversification should purchase this type of product for their portfolios. Hedge funds also have successfully operated with little regulatory scrutiny for many years, and we should not now add additional layers of unnecessary regulation in order to further protect those investors who are truly qualified to make these investments and already fully understand the risks involved.

As we consider these issues, I would further encourage my colleagues on both sides of the aisle not to make quick judgements about changing the statutory and regulatory structures governing the hedge fund industry. Unless we identify something wrong, something that endangers our capital markets, something that poses a systemic threat for our financial institutions, or something that represents bad public policy, we should defer action in this area and await the recommendations of the experts at the Securities and Exchange Commission and elsewhere. We additionally must move forward prudently and carefully in our investigations in these matters in order to ensure that we do not cause further disturbances in our already turbulent capital markets.

Finally, later this morning I expect that we will hear complaints about short selling, a strategy used by a number of successful hedge fund managers. I believe that this practice provides investors with an opportunity to use the information that they have about a particular company, industry, or financial instrument to make money. This practice, in my view, is therefore a useful investment technique. It also helps to provide needed liquidity to our capital markets. Furthermore, it is perfectly legal. In short, when fairly practiced, short selling is an important offshoot of capitalism, and we should not unnecessarily limit this practice.

Mr. Chairman, I want to commend you for bringing these matters to our attention. I look forward to hearing from each of our witnesses, especially Chairman William Donaldson who is testifying before us for the first time since he took over the helm at the SEC. I have already found his insights valuable and his leadership respected. With that, Mr. Chairman, I yield back the balance of my time.